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C O N F I D E N T I A L SECTION 01 OF 02 ANKARA 000623

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SUBJECT: TURKEY'S POLICY ON GAS TRANSIT FIRMLY UP IN THE AIR

REF: A. ANKARA 358

[1](#)B. ANKARA 490

Classified By: Economic Counselor Dale Eppler for reasons 1.4 (B) and (D)

[1](#)1. (C) Summary and comment. Turkey is at least considering a change in its strategy on natural gas transit from Azerbaijan to Europe. They appear to have gotten the message that their 15% reserve at net-back price formula (reftel A) is not viable. However, they have not yet come up with an alternative scheme that would meet their requirements for increased gas purchases at a "good price," i.e., at a price less than the Baumgarten price and calculated through a transparent formula, not set by bilateral negotiation. Energy Minister Guler has sent his advisor Faruk Demir on a listening tour to gather ideas, and they are thinking creatively about possible partnerships with SOCAR as a lever for a better gas price. We suggested hiring a professional consultant to provide industry friendly options. As a long-term option, the Turks continue to pursue the establishment of a commercial trading hub for natural gas and are pressuring the EU to support this option, although they understand this won't be the solution for the transit of Shah Deniz Phase II gas. Given that the GOT's transit strategy is in flux, we recommend against discussing the commercial details of gas transit arrangements at the April 16 trilateral (US-Tu-Az). Washington may wish to consider inviting EU Nabucco Coordinator Van Aartsen to the trilateral so we can learn the details of EU proposals to solve the Turkey-Azerbaijan gas transit impasse as it relates to Nabucco. The trilateral might also be a useful forum for a broader strategic discussion of common purpose and goals for the development of the Southern Gas Corridor. End summary and comment.

Gas transit: Goal is Clearer, Means are Not

[1](#)2. (C) For months, the Turks have repeatedly made two points to us: 1) they want to buy an increased amount of natural gas to meet their growing demand and 2) they want to buy the gas at a "good price," defined as a price lower than the Baumgarten price (roughly USD 350/tcm). Ideally, new gas supply contracts would give the Turks flexibility to increase or decrease purchase amounts, rather than lock them into long-term take or pay obligations, and the gas price would be

transparently calculated or indexed to another set of prices so that Turkish officials can avoid subsequent criminal charges if future market changes make the resulting price appear excessive. The 15% gas reserve formula at net back prices meets these GOT requirements, but is opposed by almost all other governments and private companies. We are seeing indications that the GOT may be considering scrapping this controversial formula, but they have yet to conceive of a better formula that meets their requirements.

¶3. (C) On March 27, advisor to Energy Minister Guler, Faruk Demir, told us the Minister had asked him to go on a listening tour - asking why Turkey's current natural gas negotiating position wouldn't work and brainstorming about other ways to meet Turkey's gas needs. He had just met with BP officials to solicit ideas and we understand he was told to "think creatively" about solutions that involved working with SOCAR. Demir said he was thinking broadly about how to leverage Turkey's assets in upstream Shah Deniz consortium, in the midstream transit and in the downstream gas sales to put together an attractive offer to SOCAR.

¶4. (C) It was clear that Demir (who usually speaks accurately for Energy Minister Guler) is thinking of ideas that go way beyond the usual long-term contract with fixed volumes and price. Demir mentioned several ideas, including forming a joint venture with SOCAR to transit gas across Turkey or to sell gas to the Turkish domestic market. (Note: SOCAR does have some interest in Turkey's domestic market, and recently won a tender to become a part-owner of a Turkish petrochemical refinery. End note.) At one point in the conversation, he asked us for ideas on how best to structure a deal with SOCAR for gas transit. We suggested that the GOT consider hiring a professional consultant, perhaps a retired

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oil and gas executive, to help think through options that are compatible with industry practices.

Opportunity to discuss gas transit at April 3 Shah Deniz consortium meeting

¶5. (SBU) There may be an opportunity for the GOT to float some new partnership ideas with SOCAR during an April 3 meeting with Shah Deniz consortium partners in Istanbul. The primary reason for this meeting is to discuss the technical price provisions for Shah Deniz Phase I gas. According to the consortium contract, price negotiations can be called if the contracted sales price for gas is below the "market" price for more than three consecutive quarters. Although we don't know the exact price for Shah Deniz gas, we believe Turkey receives a concessionary rate from Azerbaijan which could be as low as USD 120/tcm.

Pursuing a Natural Gas Hub

¶6. (C) Demir said Turkey will continue to pursue the idea of becoming a commercial gas hub (reftel B). He said the first step would be to build the physical infrastructure. He mentioned that he has asked a Turkish think tank, Strategic, Technical, Economic Research Center (STEAM) to host a conference on May 30 on the workings of natural gas commercial hubs and future predictions for supply and demand of the natural gas market. He said STEAM will invite Chevron representatives to explain how the Henry Hub operates. He also said Coordinator for Eurasian Energy Diplomacy Steve Mann will be invited to speak at this event.

¶7. (C) Turkey is insisting that the EU support its efforts to become a gas hub. The EU has applauded Turkey's efforts to bring its energy sector into compliance with EU directives. According to EU Economic Counselor in Ankara Ulrike Hauer, the EU is prepared to support Turkey's establishment of a natural gas hub but only after Turkey puts into place the necessary gas infrastructure, including underground gas storage, and regulatory framework for transparent operation

of the hub.

#### EU's Policy on GOT's Gas Market Liberalization May Impede Gas Transit Resolution

18. (C) The EU also is pushing Turkey to further liberalize its gas market and dismantle the state oil and gas transit monopoly, BOTAS, as required by Turkish law. (Comment: BOTAS is currently prohibited by law from signing new gas contracts, including for transit. It is seeking an amendment to the law to allow it to sign new transit deals. End note.)

The EU's position may conflict with our Caspian Strategy. If we want Turkey to swiftly conclude a transit agreement with Azerbaijan, we need a Turkish entity that is able to sign and deliver. Given its experience and ownership of the gas pipelines in Turkey, BOTAS is the best-placed entity to do that. A transit arrangement will be greatly delayed if Turkey needs to create a new corporate entity that would then need to hire qualified staff and obtain all necessary permits, sovereign guarantees, and financing before it could sign a transit deal with Azerbaijan. This would seem to be in the EU's interest as well if it considers Nabucco a priority.

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WILSON